

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2561 Rayburn House Office Building
Washington, DC 20515-6315

MEMORANDUM

TO: Members, Committee on Small Business
FROM: Nydia Velázquez, Chairwoman
DATE: December 7, 2022
RE: Committee Hearing: Oversight of the Small Business Administration

Background

The Committee on Small Business will meet for a hybrid hearing titled, “Oversight of the Small Business Administration.” The hearing is scheduled to begin at 10:00 A.M. on Wednesday, December 7, 2022, in Room 2360 of the Rayburn House Office Building, and virtually via the Zoom platform. Throughout the 117th Congress, the Small Business Administration (SBA) played an unprecedented role as the primary agency providing economic relief to small businesses adversely impacted by the COVID-19 pandemic. While the economic relief programs were designed to soften the financial impact of the pandemic, they did not come without challenges to the agency. Over the course of the past two years, the Administration worked to improve the implementation of these programs, as well as their core products and services. This hearing will provide Members an opportunity to conduct oversight of the Agency as it transitions from pandemic relief to its core mission and discuss with the Administrator her vision for the agency

Panel

- The Honorable Isabella Casillas Guzman, Administrator, United States Small Business Administration

Capital Access

One of the primary responsibilities of the SBA is to ensure that small businesses have access to capital in order to grow and scale their respective operations. The Office of Capital Access (OCA) leads the agency’s efforts in managing multiple programs to provide affordable access to capital to these small firms. These congressionally authorized programs include the 7(a) loan program, the 504/Certified Development Company (504) program, the Microloan program, and the Small Business Investment Company (SBIC) program. The support these programs provide is essential to small businesses, especially underrepresented firms as they struggle to obtain conventional loans from a bank.

During the COVID-19 pandemic SBA was responsible for establishing and instituting multiple pandemic relief programs to assist small businesses. For instance, SBA managed the Paycheck Protection Program (PPP) through which private lenders made almost \$800 billion in forgivable loans to small firms. The SBA was also in charge of administering the \$28.6 billion Restaurant Revitalization Fund. And now, OCA will oversee the agency’s efforts to service approximately

3.9 million COVID-19 Economic Injury Disaster Loans (COVID EIDL), which totaled approximately \$390 billion.¹

7(a) Program

The 7(a) program – the agency’s flagship lending program – encourages lenders to provide loans by guaranteeing a significant portion of the loan. Loans are provided to small businesses that might not otherwise obtain financing on reasonable terms and conditions. The maximum loan amount is \$5 million, and the loan can be used for working capital, refinancing business debt, or purchasing equipment and supplies. In FY 2022, the SBA approved 47,678 7(a) loans totaling more than \$25.6 billion. And in FY 2023, to date, the SBA has approved 4,184 7(a) loans totaling more than \$2.1 billion.

To improve access to 7(a) program loans for underrepresented entrepreneurs, SBA administers the Community Advantage Pilot Program through which mission-based lenders, including non-federally regulated Community Development Financial Institutions (CDFIs), CDCs, and Microloan program intermediaries make 7(a) loans up to \$350,000. The program has been successful in reaching significantly more women and minorities than the traditional 7(a) loan program.

Recently, the SBA issued three Notice of Proposed Rulemakings, which could lead to major changes in how the program operates. The first of the proposed rules was made available in the Federal Register on October 19, 2022.² Under the proposed rule, SBA is attempting to reduce barriers and increase access and diversity in the SBIC program. SBA does this by proposing to create a new class of SBICs, called Accrual SBICs. The purpose of the Accrual SBICs is to unlock more patient capital financing for small businesses and implement changes to lower financial barriers to program participation for new fund managers. According to SBA, this proposed rule will reduce financial and administrative barriers to participate in the SBIC program and modernize the program’s license offerings to align with a more diversified set of private funds investing in underserved small businesses.

On Wednesday, October 26, 2022, SBA published a proposed rule in the Federal Register titled, “Affiliation and Lending Criteria for the SBA Business Loan Programs.”³ As proposed, the rule intends to modernize the 7(a) and 504 programs by setting forth use of proceeds regarding partial changes of ownership, lending criteria, hazard insurance requirements, and reconsiderations. Specifically, the proposed regulation allows for alternative credit analysis used by lenders for SBA’s core programs, and it proposes to allow individuals to use 7(a) loan proceeds to fund partial changes of ownership. In addition, the rule proposes to simplify the principles for determining affiliation in the 7(a), 504, Microloan, Intermediary Lending Pilot Program (ILP), Surety Bond Guarantee program (SBG), and Business Disaster Loan programs.

¹ See Press Release, Four Million Hard-Hit Businesses Approved for Nearly \$390 billion in COVID Economic Injury Disaster Loans, (June 13, 2022), <https://www.sba.gov/article/2022/jun/13/four-million-hard-hit-businesses-approved-nearly-390-billion-covid-economic-injury-disaster-loans>.

² See 87 Fed. Reg. 63436 (Oct. 19, 2022).

³ See 87 Fed. Reg. 64724 (Oct. 26, 2022).

The most recent rule proposed by the SBA titled, “Small Business Lending Company (SBLC) Moratorium Rescission and Removal of the Requirement for a Loan Authorization” was published in the Federal Register on November 7, 2022.⁴ Under the proposed regulation, SBA wants to lift the existing moratorium on licensing new Small Business Lending Companies (SBLCs). SBLCs are non-depository institutions that are authorized to make 7(a) program loans. The agency has had a moratorium on licensing new SBLC’s since 1982, and it was instituted because the agency did not have the resources to properly supervise the program. Currently, the only way to obtain a SBLC license is to acquire one from one of the existing 14 SBLC licensees. Although there is no cap on the number of licenses that can be issued under the proposed rule, SBA believes that it has the capacity to authorize three new licenses in total.⁵ The agency also proposes adding a new Mission-Based SBLC. The intent behind the Mission-Based SBLC’s is to increase lending in underserved communities. Moreover, the agency intends to allow Community Advantage lenders to become Mission-Based SBLC’s as this will allow them to permanently participate in the 7(a) program.

Paycheck Protection Program

PPP was designed to assist small businesses meet payroll costs and other expenses and offers loan forgiveness if loan proceeds are spent on such purposes. In total, SBA processed approximately 11.3 million PPP loans through more than 5,400 private lenders. Since the end of the disbursement of these loans, the agency has turned its focus to processing loan forgiveness applications. As of October 23, 2022, 93 percent of all loans have been forgiven or partially forgiven.⁶ A majority of the unforgiven loans are held by sole proprietors and independent contractors, who received their loans from financial technology companies (Fintechs).⁷ Furthermore, as of September 30, 2022, SBA was actively reviewing over 32,000 loans of \$150,000 or less.⁸

Currently, more than 300,000 small businesses have not had their loans forgiven due to excess loan amount errors. An excess loan amount error is defined as a borrower or lender error made in good faith that caused a borrower to receive a PPP loan amount exceeding the borrower’s correct maximum loan amount under the CARES Act and the Economic Aid Act.⁹ These errors were honest mistakes that have detrimentally impacted underserved small businesses. The average good faith error is more than \$12,000, and surveys show that most small businesses owned by people of color cannot afford an unexpected expense of \$5,000. This debt owed by these small businesses could impact the equitable economic recovery from the pandemic.

The agency must also confront the real prospect of a significant amount of loan guaranty purchase requests from lenders. As of May 30, 2022, the SBA Office of Inspector General (OIG) found that

⁴ See 87 Fed. Reg. 66963 (Nov. 7, 2022).

⁵ *Id.*

⁶ U.S. Small Bus. Admin., Forgiveness Platform Lender Submission Metrics, (Oct. 2022), https://www.sba.gov/sites/default/files/2022-10/2022.10.24_Weekly%20Forgiveness%20Report_Public.pdf

⁷ Sacha Pfeiffer and Austin Fast, *Virtually all PPP loans have been forgiven with limited scrutiny*, NPR, October 12, 2022, <https://www.npr.org/2022/10/12/1128207464/ppp-loans-loan-forgiveness-small-business>.

⁸ Letter from Patrick Kelley, Associate Administrator for the Office of Capital Access, U.S. Small Bus. Admin, to Chairwoman Nydia Velázquez, H. Comm. on Small Bus. (Nov. 17, 2022) (on file with the H. Comm. on Small Bus.).

⁹ U.S. Small Bus. Admin., Procedural Notice 5000-20078, (Jan. 2021), <https://home.treasury.gov/system/files/136/PPP--Procedural-Notice--PPP-Excess-Loan-Amount-Errors.pdf>.

150,000 PPP recipients with loans totaling more than \$6.3 billion have not applied for forgiveness or made any principal payments.¹⁰ Of concern to the Committee is the OIG's finding that SBA has no formal process to review lender compliance with debt collection activities in its PPP loan guaranty purchase process.¹¹ The Committee plans to continue its oversight of the agency's management of the loan guaranty purchase request process.

At the beginning of the program, guardrails to prevent fraudulent activity were lowered which limited the agency's ability to combat fraud. Under the Biden Administration, SBA made substantial progress to reduce fraud risks and prevent further losses with regard to PPP. The improvements made the Biden Administration are currently being assessed by the OIG to determine their effectiveness. Even with these improvements, the OIG has listed the potential fraud associated with PPP as a top management and performance challenged for the agency in Fiscal Year 2023.¹²

Moreover, fraud associated with PPP loans facilitated by Fintechs is another issue of concern, to monitor. Reports found Fintechs and their lending partners handled 75 percent of PPP loans connected to fraud by the Department of Justice, despite facilitating only 15 percent of the loans overall.¹³ According to a study published by researchers at the University of Texas-Austin (UT-Austin), nine of the 10 PPP lenders with the highest rates of suspicious loans are Fintech companies.¹⁴ The UT-Austin research also shows the most active Fintech PPP lenders (including two Fintech companies who together processed one-third of all 2021 PPP loans) each generated over \$1 billion in processing fees from SBA.¹⁵

COVID EIDL

On May 6, 2022, SBA stopped processing COVID EIDL loan increase requests or requests for reconsiderations. This led to the agency closing down the COVID EIDL portal on May 16, 2022. With the processing of applications now complete, the agency is now moving on to servicing the COVID EIDLs. In order to service these COVID EIDLs, SBA in its Fiscal Year 2023 budget justification to Congress requested \$320 million be transferred from the Targeted COVID EIDL Advance account to support COVID EIDL servicing and other COVID-related programs. Without this transfer authority the agency could run out of funds to service these loans before the end of Fiscal Year 2023.

To handle the servicing of these loans, the agency is planning to establish a new COVID EIDL servicing unit within the Processing and Disbursement Center. The agency also plans to hire up to 2,000 COVID EIDL service staff to work in the servicing unit. In addition, the agency has

¹⁰ U.S. SMALL BUS. ADMIN., OFFICE OF INSPECTOR GEN., TOP MGMT. AND PERFORMANCE CHALLENGES FACING THE SMALL BUS. ADMIN. IN FISCAL YEAR 2023 (2022).

¹¹ U.S. SMALL BUS. ADMIN., OFFICE OF INSPECTOR GEN., SBA'S GUARANTY PURCHASES FOR PAYCHECK PROTECTION PROGRAM LOANS (2022).

¹² *Supra* note 10.

¹³ Bloomberg Businessweek, *PPP Scammers Made Fintech Companies Their Lenders Of Choice*, (Oct. 7, 2020), <https://www.bloomberg.com/news/articles/2020-10-07/ppp-loans-scammers-used-fintech-companies-to-carry-out-fraud>.

¹⁴ Griffin, John M. and Kruger, Samuel and Mahajan, Prateek, *Did FinTech Lenders Facilitate PPP Fraud?* (Dec. 6, 2021), <https://ssrn.com/abstract=3906395>.

¹⁵ *Id.*

committed to improve its customer service support center, which had major issues communicating timely and correct information to the public during the pandemic. The updates to the customer service center include changing the management and contractors, added performance and quality metrics, improved call scripts and new customer service guidelines.¹⁶

According to the Brookings Institution, the program was a success in that it was more effective than PPP in reaching small and minority owned businesses.¹⁷ Almost 20 million COVID EIDL applications were reviewed by the agency, and the immense undertaking by the agency to go through these applications is noteworthy. However, there were challenges that the agency faced with the program, the most notable issue being fraud. In fact, the OIG has listed addressing fraud associated with COVID EIDLs is one of the top management and performance challenges facing the agency in FY 2023.¹⁸ While the actual amount of fraud associated with the program is unknown at this time, the extent of suspected fraud will become more evident as borrowers begin to make payments on their loans. Of note, SBA anticipates that 30 to 50 percent of the 2.9 million COVID EIDLs with a loan amount of \$100,000 or less will default.¹⁹

Path to Employee Ownership

To further promote affordable access to capital for employee-owned businesses, Congress enacted the Main Street Employee Ownership Act of 2018 (Main Street Act).²⁰ The purpose of the Main Street Act was to utilize the 7(a) program to support business ownership transitions. However, SBA has failed to properly to support employee ownership transitions and the agency continues to refuse to implement the law as intended by Congress. Due to these failures, both cooperatives and ESOPs still face challenges accessing the 7(a) program. In fact, from FY 2018 through FY 2021, SBA has only approved 17 7(a) program loans to assist an ESOP in acquiring 51% or more of a business.²¹ SBA has even acknowledged that its current policies are not achieving its goals of increasing employee ownership of businesses.²²

To address this matter, Chairwoman Velázquez and Representative Phillips has introduced two bills to increase 7(a) program loans to employee-owned businesses. H.R. 9347, the “Main Street Employee Ownership 2.0 Act of 2022”, reinforces the efforts of the Main Street Act by eliminating burdensome lending requirements put in place by SBA. H.R. 9345, the “Improving SBA Engagement on Employee Ownership Act”, would improve SBA’s outreach and engagement on employee ownership and cooperative development.

Disaster Lending

The SBA’s disaster lending program’s main responsibility is leading the agency’s response to natural disasters, whether it is a hurricane, flood, earthquake, or tornado. Prior to the pandemic, approximately 80% of SBA’s disaster loans were awarded to individuals and households rather

¹⁶ *Supra* note 10.

¹⁸ *Supra*, note 10.

¹⁹ *Id.*

²⁰ Pub. L. No. 115-232, § 862.

²¹ *Supra* note 3.

²² *Id.*

than to businesses.²³ At the Committee’s May 18, 2022 hearing, Associate Administrator Patrick Kelley testified that the management of the disaster lending program will be transferred from the Office of Disaster Assistance (ODA) to OCA.²⁴ He also testified that ODA will continue to be involved in helping businesses and homeowners prepare for natural disasters.²⁵ The transfer of the management of the disaster lending program to OCA will require additional oversight to ensure that homeowners, renters, and business owners are receiving the services they need in a timely manner after a major disaster.

Entrepreneurial Development

SBA’s Resource Partner network of Small Business Development Centers (SBDCs), Women’s Business Centers (WBCs), SCORE Chapters, and Veterans Business Outreach Centers (VBOCs) were instrumental throughout the pandemic, meeting the historically high increase in demand for their counseling and training services. However, the pandemic illuminated the reality that access to, and knowledge of, government programs is not equitable across the country with many minority and rural communities being left behind. To address these inequities, Congress created the Community Navigator Pilot Program as part of the American Rescue Plan Act of 2021 to assist and support traditionally underserved small businesses in accessing federal relief programs.²⁶ The American Rescue Plan Act of 2021 authorized \$100 million for grants to eligible organizations to participate in the program and an additional \$75 million to support outreach and education.²⁷

On October 28, 2021, SBA awarded grants to 51 “hubs” that cover all 50 states and Puerto Rico through almost 450 “spokes” that connect directly with underserved small business owners and entrepreneurs.²⁸ The hubs are the primary awardees and broken down into three categories; national, state, and local organizations.²⁹ Hubs subcontract with no fewer than five spokes that connect small businesses and entrepreneurs with resources and assistance dealing with capital access, contracting and procurement, marketing, operations, business development, exporting, and industry specific training.³⁰ Grantees have a two-year performance period to carry out program.³¹ The SBA was also provided \$75 million to support outreach and education through marketing of the pilot program’s services, establishing a telephone hotline, conducting outreach in the 10 most commonly spoken languages, and improving SBA’s website.³²

²³ BRUCE R. LINDSAY, ET AL., CONG. RESEARCH SERVICE, SBA DISASTER LOAN INTEREST RATES: OVERVIEW AND POLICY OPTIONS 2 (2021), available at <https://www.crs.gov/reports/pdf/R46963>.

²⁴ *SBA Mgmt. Review: Office of Capital Access: Hearing Before the H. Comm. On Small Bus.*, 117th Cong. 16 (2022) (statement of Patrick Kelley, Assoc. Adm’r, Office of Capital Access, U.S. Small Bus. Admin.).

²⁵ *Id.*

²⁶ Pub. L. No. 117-2.

²⁷ *Id.*

²⁸ Press Release, Small Bus. Admin., SBA Administration Guzman, Biden-Harris Administration Announce Community Navigator Pilot Program Grantees, (Oct. 28, 2021) <https://www.sba.gov/article/2021/oct/28/sba-administrator-guzman-biden-harris-administration-announce-community-navigator-pilot-program>, *see also*, R. Corinne Blackford, CONG. RSRCH. SERV., IN11893, SBA’s Community Navigator Pilot Program, (March 15, 2022), [hereinafter CRS Comm. Nav.]

²⁹ *Community Navigator Pilot Program*, U.S. Small Bus. Admin., <https://www.sba.gov/partners/counselors/community-navigator-pilot-program>

³⁰ CRS Comm. Nav., *supra* note 29.

³¹ *Id.*

³² *Id.*

Government Contracting Programs

The primary purpose of the SBA's Government Contracting and Business Development (GCBD) programs is to assist small businesses by increasing their access to the federal marketplace. SBA administers several government-wide small business prime contracting programs. These programs are: the 8(a) Business Development program; the HUBZone Program, the Service-Disabled Veteran-Owned Small Business program (SDVOSB); and the Women-Owned Small Business (WOSB) Federal Contracting program.

In recent years, the last two programs that relied on self-certification -SDVOSB and WOSB- have been modified to require formal certification of program participants. SBA is currently standing up the platform that will serve to provide SDVOSB certifications, beginning January 1, 2023.³³ Offering formal certifications for the contracting programs requires SBA to count with an efficient and fully operational Information Technology (IT) platform. This is precisely what SBA tried to achieve with Certify.SBA.gov, an IT platform intended to serve as the single certification management system for all the contracting programs. It was also envisioned that Certify.SBA.gov would offer a multiplicity of functionalities to SBA officials, including search, analytical and reporting tools.³⁴

However, in July 2020, the SBA OIG found that the objectives of Certify.SBA.gov had not been accomplished. Basically, applications for all of the programs were never developed or lacked basic functionalities, and certain key capabilities were not implemented.³⁵ It was also reported that after having spent 4 years and \$30 million on the platform, SBA had decided to abandon Certify.SBA.gov altogether and migrate further development to another platform.³⁶

Development of the project did resume in an entirely different architecture, now deployed as www.beta.certify.sba.gov. The platform is used to process certifications for the WOSB program and has its own set of issues that require constant patches and fixes. According to a recent OIG report, the platform does not allow program officials to accurately report data or maintain proper records and does not reliably interface with DSBS- a small business search tool.³⁷

In October 2020, the SBA informed the Committee that “upon completion of the WOSB capability, SBA would perform a strategic review of the overall Certify project to determine most effective oversight, contract delivery, and technical approach for continued development.”³⁸ Based on our engagements with the agency, the strategic review has been performed. Nevertheless, SBA's development plans to have one single certification platform -along with expected costs and timelines- remain unclear. As a result, the contracting programs reside in different platforms: the

³³ William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 862.

³⁴ U.S. SMALL BUS. ADMIN., OFFICE OF INSPECTOR GEN., *Evaluation of Certify.SBA.gov* (2020).

³⁵ *Id.*

³⁶ *Id.*

³⁷ U.S. SMALL BUS. ADMIN., OFFICE OF INSPECTOR GEN., *SBA's Implementation of the Women-Owned Small Business Certification program* (2022).

³⁸ Letter from Francis Spampinato, Associate Administrator for the Office of Government Contracting and Business Development, U.S. Small Bus. Admin, to Representative Jared Golden, Chairman of the Subcommittee on Contracting and Infrastructure (Oct. 19, 2020) (on file with the Committee on Small Business).

8(a) program in Certify.gov, WOSB in Beta.Certify, HUBZone in the HUBZone Certification Tracking System and now SDVOSB will reside in a new custom-built platform. Furthermore, it is unclear what search, analytical and reporting tools the platform will incorporate, if any. Until this day, SBA officials must rely on manual, labor-intensive and time-consuming processes to compile basic program data,³⁹ which hinders oversight.

Technology

For more than twenty years, the SBA OIG has listed information technology (IT) security as a one of the most serious management and performance challenges facing the SBA. In the Fiscal Year 2020 management challenges report, the OIG found that the agency continued to face significant risks in deploying IT and cybersecurity controls.⁴⁰ These vulnerabilities were exposed by the rollout of the SBA's COVID-19 relief programs. The unprecedented demand for the SBA's relief programs, the Economic Injury Disaster Loan Program (EIDL), and the Paycheck Protection Program (PPP) inundated SBA's legacy systems, leading to backend system crashes, portals operating slowly, and a glitch that led to a data breach of applicants' personal information.

In the Fiscal Year 2023 management challenges report, the OIG listed three main concerns: SBA's IT investment controls need improvement; existing system development and monitoring controls need to reflect changing IT design risks; and the SBA's overall level of "not effective" according to the maturity model criteria of the Federal Information Security Management Act of 2002 (FISMA) annual evaluation.⁴¹

Conclusion

The SBA is a small agency that has played an outsized role in distributing more than \$1 trillion in pandemic aid to small businesses. Congressional oversight of the agency and its use of federal funds is a vital role of the Small Business Committee. To that end, the Committee has held numerous oversight hearings in this Congress and the 116th. Given the unprecedented level of economic aid delivered to small businesses, and need for robust oversight, this hearing will provide Members of the Committee with an opportunity to conduct a full review of the agency and determine if the agency is focused on its core mission of responsibly serving our nation's 32 million small businesses.

³⁹ See U.S. Gov't Accountability Off., GAO-22-104512, *Small Business Administration: Recent Changes to the 8(a) Program's Financial Thresholds Need Evaluation* (2022).

⁴⁰ U.S. SMALL BUS. ADMIN., OFFICE OF THE INSPECTOR GEN., 20-01, REPORT ON MOST SERIOUS MGMT. AND PERFORMANCE CHALLENGES FACING THE SMALL BUS. ADMIN. IN FISCAL YEAR 2020 (2019).

⁴¹ *Supra* note 10.